

ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Strickland/Kaloogian Analyst: Kimberly Pantoja Bill Number: AB 296

Related Bills: None Telephone: 845-4786 Amended Date: 03/23/99

Attorney: Doug Bramhall Sponsor: Franchise Tax Board

SUBJECT: Penalty For Failure To File Upon Notice And Demand

SUMMARY OF BILL

This Franchise Tax Board-sponsored bill would amend the penalty for failure to file a personal income tax return upon notice and demand. The bill would change the imposition of the 25% demand penalty from application against the total tax before allowing credits and withholding to application against the unpaid tax after allowing credits and withholding.

SUMMARY OF AMENDMENT

The March 23, 1999, amendments made additional changes to how the penalty for failure to file a return upon notice and demand would be calculated and changed the effective date.

EFFECTIVE DATE

This bill would be operative on January 1, 2000, and would apply to all demand penalties imposed after that date.

SPECIFIC FINDINGS

Existing state law authorizes the Franchise Tax Board (FTB) to issue a notice and demand for information and/or tax returns. Additionally, the law provides that if a taxpayer either (1) fails to furnish any information requested in writing by FTB or (2) fails or refuses to file a required tax return upon notice and demand, the department may add a penalty. This penalty is equal to 25% of the amount of tax (prior to application of credits, including withholding) determined from any available information or any deficiency tax assessed by the department concerning the assessment of which the information or return was required. This "demand penalty" is not assessed if the postal service is unable to deliver the notice because of an erroneous address. If the address is incorrect, department staff attempts to identify a more current address and, upon doing so, reissues the notice. Also, this penalty may not be assessed if it is determined that the failure to file the return or furnish information was due to reasonable cause, not willful neglect.

The department's audit staff will make every reasonable effort to obtain information necessary to conduct an audit and support its conclusions and recommendation. When the requested information is not furnished, the auditor will prepare and issue a formal demand for information. Audit staff will impose assessment of the failure to furnish information penalty in cases where the formal demand is refused or ignored.

Board Position:

<u> X </u> S	<u> </u> NA	<u> </u> NP
<u> </u> SA	<u> </u> O	<u> </u> NAR
<u> </u> N	<u> </u> OUA	<u> </u> PENDING

Department Director

Date

Johnnie Lou Rosas

4/1/1999

The "demand penalty" may cause taxpayers to incur penalties where they actually have no unpaid tax liability.

This bill would change the imposition of the 25% demand penalty from application against the total tax before allowing credits and withholding to application against the tax after allowing credits and withholding. This bill would impose the penalty only on taxpayers who both owe tax and do not provide a return when requested. Individuals who would have been entitled to a refund would not owe the penalty.

Thus, **the bill** would ensure that the penalty for failure to file upon notice and demand is not overly burdensome, particularly for taxpayers who would have been due a refund had they timely filed their return.

Policy Considerations

The penalty for failure to file upon notice and demand has been criticized as excessive as the taxpayer is subject immediately to a penalty of 25% of the total tax liability, even if the taxpayer would have been due a refund had a return been timely filed. Assessing the penalty after allowing for credits and withholding would result in a smaller penalty amount for taxpayers who have had withholding or made other tax payments and eliminate the penalty for those who are owed a refund.

Implementation Considerations

This bill would change the manner of calculating the penalty for failure to file upon notice and demand; however, the department's procedures for assessing the penalty would remain the same.

Currently in filing enforcement situations, a Notice of Proposed Assessment (NPA) is issued within 50-60 days after the issuance of the notice and demand for a missing return. The manner in which the penalty is calculated is shown as part of the NPA. This conforms to the department's policy of advising taxpayers at the earliest opportunity of proposed assessments.

Under this bill, the notice and demand letter would advise the taxpayer that if a return (or an explanation of why a return is not required) is not filed within 30 days, the demand penalty will be imposed. Additionally, the letter would identify the demand penalty as being calculated after allowing for credits and withholding. This bill would require changes to the department's systems to recognize that the penalty will be after credits and withholding. The changes needed are estimated to be moderate.

FISCAL IMPACT

Departmental Costs

This bill would not significantly impact the department's costs.

Tax Revenue Estimate

The revenue impact of this bill is estimated to be as follows:

Estimated Impact of AB 296			
Penalties Imposed on or After			
January 1, 2000			
Fiscal Year Impact			
1999-0	2000-1	2001-2	2002-3
(\$3)	(\$12)	(\$15)	(\$15)

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this bill.

Tax Revenue Discussion

The revenue impact of this bill would be determined by the difference in demand penalties levied under current law for failure to file a return and demand penalties that would be levied under the proposed change. Demand penalties assessed for failure to file a return under current law (predominantly from filing enforcement rather than audit) amount to approximately a net \$125 million annually (on \$500 million of computed tax under PITL) based on a two-year average. This bill would replace the current 25% of total tax with 25% of tax owed.

Estimates are based on actual assessment data and information from the department's filing enforcement program. It is not anticipated that this change would significantly alter current payment patterns and responses of taxpayer.

BOARD POSITION

Support.

The Franchise Tax Board voted to support changing the calculation of this penalty at its December 16, 1998, meeting.